House Budget Committee
Democratic Caucus
U.S. Rep. John Spratt ■ Ranking Democratic Member

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January 31, 2001

New CBO Surplus Estimates: Less Than Meets the Eye

Dear Colleague,

Today, the Congressional Budget Office (CBO) projected that the unified budget surplus for 2002-2011 will total $5.610 trillion, significantly more than estimated just last July. Outside Social Security and Medicare, CBO projects a ten-year surplus of $2.730 trillion, also a substantial upward revision.

While the improving fiscal situation is welcome news, the rush of proposals to dispose of the entire projected surplus for the next ten years is not. The attached analysis by the Democratic staff of the House Budget Committee shows that the amount of the surplus realistically available for tax cuts and spending initiatives is actually far more limited. As always, responsible budgeting still requires hard choices.

Furthermore, we should look with skepticism on the notion that this Congress is under some obligation to dispose of the entire surplus that CBO projects for the next ten years. Future Congresses undoubtedly will face challenges that we do not foresee, and disposing of the entire surplus would leave no resources to address them.

One major fiscal challenge that we do foresee is the effect of the Baby Boom's retirement on Social Security and Medicare. The first Baby Boomers begin to retire in 2008. Disposing of the entire available surplus now, rather than paying down debt, will leave the government's finances in more precarious shape when the budgetary tidal wave hits.

Finally, these projections are highly uncertain—particularly for the years farthest in the future. We have been lucky in recent years to see budget estimates unexpectedly turn in our favor. They could just as easily turn against us.

I hope that you consider the attached analysis. If you have questions, please do not hesitate to contact me or the Budget Committee's Democratic staff.

Sincerely,

John Spratt

John M. Spratt, Jr.
Ranking Democratic Member

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A Realistic Assessment of the New Budget Outlook

The Congressional Budget Office (CBO) now projects that unified surpluses from 2002 through 2011 will total $5.610 trillion. This is $1.049 trillion higher than CBO's July projection for 2001 through 2010. Surpluses for Social Security and Medicare account for most of the total surplus, but most of the upward revision since last July's projection is outside those two programs.

CBO Projected Budget Surpluses

Billions of Dollars

	2002	2002-2006	2007-2011	2002-2011
Total (Unified) Budget Surplus	313	2,007	3,603	5,610
Social Security Surplus (includes Postal Service transfers)	171	1,019	1,468	2,488
Medicare HI Surplus	36	200	192	392
Remaining On-Budget Surplus	106	788	1,943	2,730

Last year, substantial majorities of both parties in Congress voted to take the Medicare HI surplus "off-budget," treating it just like the Social Security surplus and transfers to and from the Postal Service, which already are off-budget. As shown in the table above, this reduces the resources available for tax cuts and spending initiatives over the next ten years by $2.880 trillion to $2.730 trillion.

In addition, the table shows that CBO estimates that only 29 percent of the remaining surplus occurs within the next five years. By far, the greatest part of the surplus is expected to appear after 2006 — where projections are most uncertain. This significantly constrains the resources available in the near term for tax cuts or spending increases and raises concerns about policies that would a commit substantial portion of the surpluses that we hope will materialize after 2006.

Actually, there is even less money available for new initiatives than these figures would suggest. The so-called CBO "baseline" surpluses assume that current spending and tax laws continue unchanged. However, maintaining current law is not the same as maintaining current policy. For instance, current law calls for several tax preferences, like the R&E tax credit and the welfare-to-work credit, to expire. These popular tax provisions have always been renewed and will be renewed again.

Similarly, the individual alternative minimum tax (AMT), which originally was intended to apply only to the most affluent taxpayers, will increasingly hit middle-class families over the next ten years — largely because it is not indexed for inflation. The Joint Tax Committee (JCT) estimates that the number of taxpayers subject to the AMT will rise to 15 million by 2011 from about 2 million currently. JCT estimates that 29 percent of taxpayers between $75,000 and $100,000 will be subject to the AMT by 2010 unless Congress changes the current law. Surely, Congress will act to amend the AMT before that happens.

On the spending side, CBO assumes that the purchasing power of appropriated programs will be held constant by increasing their costs at the rate of inflation. This also understates the cost of maintaining current policy, if only because population grows. For instance, increasing Head Start funding by only the rate of inflation means that a declining percentage of children eligible for the program will be served. Similarly, funding needed for programs like transportation infrastructure, law enforcement, and the environment, to name a few, also tend to grow along with both inflation and population. Historically, appropriations have tended to grow somewhat faster than inflation alone.

CBO's baseline makes no provision for natural disasters. Although one cannot predict when disasters will strike, it is certain that over the next ten years earthquakes, wildfires, hurricanes, and floods will occur, costing the federal government.

In addition, Congress has routinely voted to provide extra help for farmers on top of farm assistance programs already in place. For the last three years, this extra assistance has averaged about $8 billion per year. Furthermore, disasters specific to agriculture, like droughts and floods, occur periodically, and Congress always provides help, sometimes measured in billions of dollars.

Finally, CBO's projections assume that the entire surplus is devoted to debt reduction — which reduces interest costs. If the Congress changes current law to account for the highly likely commitments above — expiring tax provisions, the AMT, realistic appropriations, disasters, and farm assistance — interest on the public debt will be higher. Such additional debt service typically adds about 20 percent to the cost of any tax cut or spending.

The table below shows how these considerations shrink the budgetary resources available for new initiatives. Deducting rough estimates of the cost of meeting these commitments, as opposed to blindly adhering to current law, reduces the available surplus to about $1.9 trillion.

The Costs of Meeting Likely Obligations

Trillions of Dollars

	2002-2011
Non-Social Security, Non-Medicare Surplus	2.7
Less:	
Extend Expiring Tax Provisions and Fix AMT	0.2
Realistic Appropriations (Population, Farm Aid, and Disasters)	0.5
Additional Debt Service	0.1
Surplus Realistically Available for New Tax and Spending Initiatives	1.9

The $1.9 trillion available for new tax cuts and spending increases is still a substantial sum of money, but it is not limitless. The prospect of mounting surpluses has provoked both tax cut and spending proposals. There are suggestions that Congress should accelerate and even add to President Bush's tax package. It has been suggested also that Congress add business tax cuts, such as a capital gains reduction or faster depreciation, as well as household tax cuts considered in the 106th Congress that failed to become law, like the expansion of IRAs and tax incentives for health insurance. On the spending side, both parties have committed to expanded drug coverage for seniors, more funds for education, and more for military modernization.

Clearly, not all of the promises made in the last campaign can be honored within the budget surplus that is realistically available. There is a real danger that without some overall budget framework to constrain Congress, debt reduction will become an afterthought, and the Social Security and Medicare surpluses will again be invaded to fund other government purposes.

Finally and perhaps most important, it is not prudent to spend every penny of a projected surplus that may not materialize — especially in the face of the highly unpredictable costs that the Baby Boomer's retirement will impose. We must enter the next decade with something in hand to protect against the costs of anticipated and unanticipated burdens.